Corporate tax update

Second quarter 2017

Welcome to the latest edition of our Corporate Tax Update, written by members of RPC's tax team and published quarterly. In this edition we highlight some of the key tax developments of interest to UK corporates from the second quarter of 2017.

Finance Act 2017

A much-shortened version of the Finance Bill 2017 received Royal Assent on 27 April 2017. A number of the provisions included in the (apparently longest ever) Finance Bill published on 20 March 2017 were removed on account of the calling of the snap General Election and the need to fast-track the Bill through Parliament before it was dissolved on 3 May. more›

Corporation tax – general

First-tier Tribunal holds price paid for dividend rights not tax deductible

On 12 June 2017, the First-tier Tribunal held that the price paid for the acquisition of rights to receive dividends was not deductible for corporation tax purposes. more›

First-tier Tribunal holds that IFRS2 debits on grant of employee share options were tax deductible

On 14 June 2017, the First-tier Tribunal held that accounting debits made in accordance with IFRS2 on the grant of employee share options were deductible from the employer company's corporation tax computation. more›

Upper Tribunal upholds decision that VAT refunds (and interest) are subject to corporation tax

On 31 May 2017, the Upper Tribunal agreed with a First-tier Tribunal decision that repayments of overpaid VAT (and related interest) are subject to corporation tax on receipt. more›

Group companies denied credit against failed avoidance scheme PAYE/NICs for corporation tax paid

On 25 May 2017, the First-tier Tribunal held that members of a group of companies could not claim credit for corporation tax paid (on the assumption that a failed tax avoidance scheme would work) against PAYE and national insurance contributions (NICs) liabilities of another group member that arose on failure of the scheme. more›

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VAT

ECJ decision on VAT cost sharing exemption could affect UK rules

On 4 May 2017, the ECJ held that Luxembourg's VAT cost sharing exemption (CSE) was not compliant with EU law, in a decision that could have ramifications for the UK's CSE. more›

B2C telecommunications services – draft legislation published to remove "use and enjoyment" rule

On 21 April 2017, the government published a draft statutory instrument for the purposes of removing the "use and enjoyment" rule for B2C supplies of mobile phone services. more›

VAT recovery for holding companies – revised HMRC guidance published

On 20 April 2017, HMRC published revised guidance on the ability of holding companies to recover input tax on acquisition, holding and management costs. more›

Overpaid VAT – no common law restitution claim for final consumers against HMRC

On 11 April 2017, the Supreme Court held, in the long-running *Investment Trust Companies* case, that the final consumers of services (in this case the investment trust companies (ITCs)) were not entitled to claim directly against HMRC for VAT (incorrectly) charged in accordance with UK VAT legislation which, at the time, was not compliant with EU law. more›

AG's opinion on scope of VAT cost sharing exemption offers hope to insurers and banks

On 5 April 2017, the advocate general (AG) in the case of *European Commission v Federal Republic of Germany* opined that German VAT legislation restricting the VAT cost sharing exemption (CSE) to activities in the "public interest" was incompatible with the VAT Directive. more›

Miscellaneous

High Court rules that judicial review not available where DPT statutory review and appeals process applies

On 29 June 2017, the High Court refused a taxpayer's attempt to seek judicial review of a decision by HMRC to impose a charge under the diverted profits tax (DPT) legislation in Finance Act 2015. It was the court's view that the taxpayer was protected under the statutory review and appeals process contained within the DPT legislation. more›

Tax issues for the "gig" economy – updated OTS paper published

On 22 June 2017, the Office of Tax Simplification (OTS) published an updated paper on tax issues for the "gig" economy. more›

First-tier Tribunal holds that double tax treaty can apply where the contracting states seek to tax different persons

On 7 April 2017, the First-tier Tribunal held that a double tax treaty (in this case, the UK-Mauritius DTT) can apply where the two contracting states are seeking to tax different persons. more›

Double tax treaty passport scheme – revised rules

On 6 April 2017, HMRC published its revised guidance on (and terms and conditions of) the double taxation treaty passport (DTTP) scheme. more›

Finance Act 2017

A much-shortened version of the Finance Bill 2017 received Royal Assent on 27 April 2017. A number of the provisions included in the (apparently longest ever) Finance Bill published on 20 March 2017 were removed on account of the calling of the snap General Election and the need to fast-track the Bill through Parliament before it was dissolved on 3 May.

The removed provisions would, according to a statement made before the election, be reintroduced at the earliest opportunity in the new Parliament. On 21 June 2017, as part of the Queen's Speech, it was announced that a Finance (No.2) Bill 2017 will be published after the summer Parliamentary recess. It has now been confirmed that this year's second Finance Bill will include these removed provisions, which include:

- corporation tax loss reform
- new rules on interest deductibility
- changes to the substantial shareholding exemption (SSE) regime

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Corporation tax – general

First-tier Tribunal holds price paid for dividend rights not tax deductible

On 12 June 2017, the First-tier Tribunal[1] held that the price paid for the acquisition of rights to receive dividends was not deductible for corporation tax purposes.

A number of steps were undertaken as part of the arrangements in this case but, essentially, the taxpayer bought the right to receive dividends from a related party before selling the right to an unconnected party a day later. The taxpayer submitted its corporation tax return for the year in question on the basis that the arrangements had generated a substantial trading loss. The taxpayer's position was that:

- the price paid for the dividend rights was tax deductible from the profits of its banking trade, but
- the sale price received was not taxable.

The taxpayer was seeking to avail itself of a tax treatment which, at the relevant time, was afforded by section 730(3) of ICTA 1988 (now contained in the income stream transfer rules in CTA 2010).

After an extensive review of the facts and relevant case law, the Tribunal held that:

- the price paid for the dividend rights was **not** deductible for corporation tax purposes, as this was not a trading transaction within the course of the taxpayer's trade. Although the Tribunal accepted that the dividend rights were "analogous" to other financial instruments in which the taxpayer dealt for the purposes of realising profit, "looking at all the circumstances, including the inception of the transaction and the manner of its implementation…this transaction was not trading in financial instruments for a profit but was a tax recovery device". This conclusion determined the appeal
- in any event, the price paid was not incurred "wholly and exclusively" for trade purposes. The Tribunal held, looking at the subjective intentions of the taxpayer, that it had a non-trading purpose (ie securing the tax benefit) in incurring the expenditure, with the result that the price was not paid "exclusively" for trade purposes
- the amount received by the taxpayer for the subsequent sale of the dividend rights was not to be excluded from the taxpayer's profits subject to corporation tax.

The decision demonstrates, amongst other things, that the "wholly and exclusively" test is separate to that of whether the transaction is a trading one. Although the answers in each case will often point in the same direction, it should not be taken for granted that meeting the "trading" test will automatically mean that the "wholly and exclusively" test is met.

The decision can be viewed here.

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1. In *BNP Paribas SA (London Branch) v HMRC* [2017] UKFTT 0487 (TC)).

First-tier Tribunal holds that IFRS2 debits on grant of employee share options were tax deductible

On 14 June 2017, the First-tier Tribunal held[2] that accounting debits made in accordance with IFRS2 on the grant of employee share options were deductible from the employer company's corporation tax computation. The facts of the case pre-date changes made to the Corporation Tax Act 2009 by Finance Act 2013.

The appellant (subsidiary) companies paid amounts to their parent company whenever the parent granted share options to employees of the subsidiaries. The subsidiaries claimed that these payments were deductible for corporation tax purposes, but HMRC disagreed.

Under IFRS2 and in these circumstances, on the grant of an employee share option the employer company must debit the fair value of the option in its accounts. It is the employer company that must so account, even if the shares under option are shares in another group company (for example, as in this case, in the parent company of the employer).

In this case the appellant companies accounted under IFRS, and debited amounts on grant of employee share options by the parent in accordance with IFRS. Although this was common ground, HMRC refused a corporation tax deduction as (on alternative grounds):

- the expenses were not, according to HMRC, incurred "wholly and exclusively" for trading purposes
- the expenses were, according to HMRC, capital rather than revenue in nature
- section 1038 of CTA 2009 (as in force at the relevant time) prevented a corporation tax deduction in this case.

The Tribunal had little difficulty in dismissing HMRC's arguments on points 1 and 2. For tax deductibility purposes, the test of being "incurred" was met when a debit was reflected in a company's accounts in accordance with applicable accounting standards. The debits were, in the Tribunal's view, recurring costs that were revenue in nature.

On point 3 the Tribunal also dismissed HMRC's argument, favouring the appellants' view that whilst Part 12 of CTA 2009 (as in force at the relevant time) was concerned with tax relief on an acquisition of shares (pursuant to options) the present IFRS debits related to the grant of options. Section 1038, which denied a deduction when relief is "available" under Part 12, therefore was not triggered.

It should be noted that Part 12 of CTA 2009 was amended by Finance Act 2013 for accounting periods ending on or after 20 March 2013. The Government's view appears to be that the FA 2013 changes served only to "clarify and confirm" the correct position, namely that (i) no corporation tax deduction is available in respect of employee share options that are not exercised, and (ii) an employer company should not be able to benefit from both a specific statutory deduction under Part 12 of CTA 2009 and a deduction for accounting expenses on grant of an option. The decision in *NCL Investments Limited* clearly casts doubt as to whether the FA 2013 changes merely clarified the correct tax treatment.

It seems likely that HMRC will appeal the First-tier Tribunal's decision.

The decision can be viewed here.

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2. In *NCL Investments Limited v HMRC* [2017] UKFTT 0495 (TC).

Upper Tribunal upholds decision that VAT refunds (and interest) are subject to corporation tax

On 31 May 2017, the Upper Tribunal[3] agreed with a First-tier Tribunal decision[4] that repayments of overpaid VAT (and related interest) are subject to corporation tax on receipt.

The decision can be viewed here.

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Group companies denied credit against failed avoidance scheme PAYE/NICs for corporation tax paid

On 25 May 2017, the First-tier Tribunal[5] held that members of a group of companies could not claim credit for corporation tax paid (on the assumption that a failed tax avoidance scheme would work) against PAYE and national insurance contributions (NICs) liabilities of another group member that arose on failure of the scheme.

The Upper Tribunal had already decided (in 2015) that the scheme, whereby employees gave up part of their salary in return for dividends, had failed. See here for our earlier commentary on the Upper Tribunal decision.

The issue before the First-tier Tribunal in the present case was whether corporation tax paid under self-assessment by the appellants, acting on the basis that the avoidance arrangements had their intended consequences, could be credited against the PAYE and NICs liabilities that the Upper Tribunal had in 2015 rules arose on failure of the scheme.

The Tribunal had little sympathy that the group was, in effect, being taxed twice as a result of the failure of the avoidance scheme. Quoting an unrelated decision of the Court of Appeal[6]; "it does not seem to us that they can legitimately complain if the scheme fails in its purpose and instead results in their paying tax twice."

The decision can be viewed here.

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3. In *Coin-A-Drink Ltd v HMRC* [2017] UKUT 211 (TCC)).
4. For our earlier commentary on the First-tier Tribunal decision, see here.
5. In *James H Donald (Darvel) Ltd v HMRC* [2017] UKFTT 0446 (TC)
6. In *Greene King plc & Greene King Acquisitions Ltd v HMRC* [2016] EWCA Civ 782.

VAT

ECJ decision on VAT cost sharing exemption could affect UK rules

On 4 May 2017, the ECJ[7] held that Luxembourg's VAT cost sharing exemption (CSE) was not compliant with EU law, in a decision that could have ramifications for the UK's CSE.

The CSE, broadly, provides for an exemption for VAT on services provided within groups whose members make exempt (or non-business) supplies provided certain conditions are met. The Luxembourg CSE rules deem a group to carry on exempt/non-business activities provided no more than 30% of the group's annual turnover relates to taxable activities. The ECJ has held that this contravenes EU law, which could have ramifications for the UK's CSE rules which has a similar, albeit less generous, threshold of 15%.

The decision can be viewed here.

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B2C telecommunications services – draft legislation published to remove "use and enjoyment" rule

On 21 April 2017, the government published a draft statutory instrument for the purposes of removing the "use and enjoyment" rule for B2C supplies of mobile phone services.

Currently, telecommunications services provided to individual consumers that are effectively used and enjoyed outside of the EU are not subject to UK VAT. From 1 August 2017, in order to prevent VAT avoidance and to make the UK VAT rules in this area consistent with the approach of other EU member states, UK VAT will apply to mobile phone services supplied to UK individuals wherever those services are used.

The draft legislation can be viewed here.

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VAT recovery for holding companies – revised HMRC guidance published

On 20 April 2017, HMRC published revised guidance on the ability of holding companies to recover input tax on acquisition, holding and management costs. This follows on from the HMRC Brief published in September 2014 (following the Court of Appeal decision in *BAA plc*[8]) and the ECJ decision in *Larentia + Minerva*[9].

The revised guidance contains some welcome developments, in particular the fact that HMRC have dropped their previously published policy of requiring acquisition costs to be "recouped" within a "sensible period of around 5 to 10 years". According to the revised guidance, VAT on acquisition costs can be recovered provided:

- the claimant holding company is the recipient of the supply
- the claimant holding company carries on an "economic activity" (which, in the context of a holding company, could be the supply of genuine management services to its subsidiaries, for a consideration which is more than nominal)
- that economic activity involves the making of "taxable supplies"

7. In *European Commission v Grand Duchy of Luxembourg* (Case C-274/15).
8. [2013] EWCA Civ 112.
9. *Beteiligungsgesellschaft Larentia + Minerva mbH & Co. KG (Case C 108/14)* and *Marenave Schiffahrts AG (Case C 109/14).*

- if the claimant holding company is part of a VAT group, it makes taxable supplies or interest-bearing loans to group members and these support the making of taxable supplies by the VAT group.

Acquisition costs will need to be apportioned, for VAT recovery purposes, if only certain subsidiaries are to be actively managed by the holding company.

There is also a new paragraph on "stewardship costs", defined by the HMRC guidance as those supplies invoiced to the holding company for convenience only, even though they are for the purposes of the wider VAT group. Group audit fees, group legal costs and regulatory compliance costs are given as examples. The revised guidance confirms that input tax incurred by the holding company on such costs shall be treated as costs of the group, rather than the holding company, for VAT recovery purposes.

It still remains important for early consideration to be given to the likely recovery of VAT on acquisition costs, and – in particular – for any management services to be supplied by a holding company to be clearly defined, priced and documented before the acquisition costs are incurred.

The revised guidance can be viewed here, here and here.

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Overpaid VAT – no common law restitution claim for final consumers against HMRC

On 11 April 2017, the Supreme Court held[10], in the long-running *Investment Trust Companies* case, that the final consumers of services (in this case the investment trust companies (ITCs)) were not entitled to claim directly against HMRC for VAT (incorrectly) charged in accordance with UK VAT legislation which, at the time, was not compliant with EU law. Rather, the final consumers' recourse was against the suppliers (in this case, the investment managers) which had charged the VAT.

The ITCs' claims related to VAT "overcharged" by the investment managers:

- for periods after 4 December 1996, in respect of which a 3-year time limit had prevented the investment managers from making a claim against HMRC under section 80 of the VATA 1994; and
- for periods prior to 4 December 1996, being the difference between the VAT (over)paid to the investment managers and the amounts reimbursed to the managers by HMRC following section 80 claims by the managers. This amount claimed by the ITCs equated to the input tax claimed by the managers.

The court's view was that section 80 of the VATA 1994 in effect barred claims against HMRC by final consumers. The options open to the ITCs were limited to claims against the investment managers, as it was not, on the facts and in the court's view, "impossible or excessively difficult" for the ITCs to make a claim in restitution against the managers. Unfortunately the court did not consider what might qualify as being impossible or so difficult, beyond commenting that insolvency of the supplier would qualify.

The decision can be viewed here.

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10. *HMRC v The Investment Trust Companies (in liquidation)* [2017] UKSC 29.

AG's opinion on scope of VAT cost sharing exemption offers hope to insurers and banks

On 5 April 2017, the advocate general (AG) in the case of *European Commission v Federal Republic of Germany*[11] opined that German VAT legislation restricting the VAT cost sharing exemption (CSE) to activities in the "public interest" was incompatible with the VAT Directive[12].

The CSE, broadly, provides for an exemption for VAT on services provided within groups whose members make exempt (or non-business) supplies provided:

- the intra-group supplies are "directly necessary" to enable the group members to make such exempt (or non-business) supplies;
- only each member's exact share of the cost of the intra-group supplies are recovered; and
- exempting the intra-group supply would not lead to distortion of competition.

The UK's cost sharing exemption (CSE)[13] closely follows the wording of Article 132(1)(f) of the VAT Directive. The UK's CSE does not, however, refer to activities "in the public interest" (unlike the heading of the Chapter of the VAT Directive which contains the CSE). HMRC's published guidance makes clear HMRC's view that no such restriction applies to the CSE, so that insurers, banks and other financial service providers have assumed the CSE can apply to their internally-provided services.

The AG in the present case took the view that the VAT Directive heading was not determinative.

This latest opinion will be welcomed by those exempt sectors, notably banking and insurance, that will have been greatly concerned by earlier opinions of a different AG in two separate cases, which included the opposite conclusion.

It now falls to the ECJ to decide which opinion it will follow, and this will be watched closely by insurers, banks and others.

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11. Case C-616/15.
12. 2006/112/EC.
13. Group 16 of Schedule 9 to VATA 1994.

Miscellaneous

High Court rules that judicial review not available where DPT statutory review and appeals process applies

On 29 June 2017, the High Court[14] refused a taxpayer's attempt to seek judicial review of a decision by HMRC to impose a charge under the diverted profits tax (DPT) legislation in Finance Act 2015. It was the court's view that the taxpayer was protected under the statutory review and appeals process contained within the DPT legislation.

HMRC argued before the court that the taxpayer could not seek judicial review of its decision to charge DPT as other avenues (ie the statutory DPT-specific process) had not been exhausted. The court was not persuaded by the claimant's arguments, which included that judicial review would save time and expense (as compared to the statutory DPT process) and that the DPT route could only consider a review as to the **amount** of DPT payable (and not whether DPT was in fact due at all).

The decision can be viewed here.

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Tax issues for the "gig" economy – updated OTS paper published

On 22 June 2017, the Office of Tax Simplification (OTS) published an updated paper on tax issues for the "gig" economy. Quoting a dictionary definition of the term, the paper describes the gig economy as one which involves a way of working that "is based on people having temporary jobs or doing separate pieces of work, each paid separately, rather than working for an employer".

Whilst the paper stops short of making recommendations, it raises a number of issues designed to "promote discussion", including:

- VAT: the paper highlights that certain organisations operating within the gig economy may be gaining a competitive advantage by not charging VAT (as compared to other providers adopting a more traditional structure)
- the much-discussed difference in NICs treatment between the self-employed and employed
- the possibility that the "hirer" could be required to withhold PAYE/NICs, or some other amount, from the fees they pay for the service provided.

The OTS paper can be viewed here.

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First-tier Tribunal holds that double tax treaty can apply where the contracting states seek to tax different persons

On 7 April 2017, the First-tier Tribunal[15] held that a double tax treaty (in this case, the UK-Mauritius DTT) can apply where the two contracting states are seeking to tax different persons.

The Tribunal dismissed the appellants' appeal, so that the gains in question were taxable in the UK (and not, as the appellants had hoped, in Mauritius under an effective "round the world" tax avoidance scheme) on the basis that the place of effective management of the trusts in question was the UK.

14. In *Glencore Energy UK Ltd v HMRC* [2017] EWHC 1476 (Admin).
15. In *Lee and Bunter v HMRC* [2017] UKFTT 0279 (TC).

Despite the Tribunal's conclusion on the question of place of effective management, the Tribunal nonetheless considered the "different persons" argument raised by HMRC. HMRC had contended that the DTT did not apply as the UK was seeking to tax the trustees, whilst Mauritius was seeking to tax the trust. The Tribunal rejected this argument, on the basis that the focus of both the UK-Mauritius DTT, and the OECD Model Convention on which it is based, is on the category of income/gain, not the identity of the person liable to tax.

The decision can be viewed here.

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Double tax treaty passport scheme – revised rules

On 6 April 2017, HMRC published its revised guidance on (and terms and conditions of) the double taxation treaty passport (DTTP) scheme. This follows on from last year's consultation on proposed changes to the regime, and the response published at this year's Spring Budget.

The new guidance confirms the previously announced extension of the regime to:

- all UK borrowers that have UK withholding tax obligations (to include partnerships, individuals and charities, ie not just corporate borrowers)
- "transparent" lenders, provided that all beneficial owners of the income are eligible for the same treaty benefits and are resident in the same jurisdiction
- sovereign and pension fund lenders, again provided that all beneficial owners of the income are eligible for the same treaty benefits and are resident in the same jurisdiction.

There are, however, other more subtle changes which are not as welcome. HMRC no longer commit to a 30-day turnaround period (from submission of form DTTP2) for issuing directions for the borrower to withhold at the applicable treaty rate.

The revised guidance, terms and conditions can be viewed here.

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